No. 21,222

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

P. R. McCLUNG,

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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I N D E X

CITATIONS

Cases:

Statutes:

Miscellaneous:

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OPINION BELOW

The memorandum finding of fact and the opinion of the Tax Court (Doc. No. 23) are not officially reported.

JURISDICTION

This petition for review (Doc. No. 25) involves federal income taxes for the year 1960. The Commissioner of Internal Revenue mailed to the taxpayer a notice of deficiency dated January 23, 1964, asserting deficiencies in those taxes in the aggregate amount of $160.06. Within 90 days thereafter on April 22, 1964, the taxpayer filed a petition (Doc. No. 2) with the Tax Court, for a

redetermination of those deficiencies under the provisions of Section 6213 of the Internal Revenue Code of 1954. The decision of the Tax Court was entered on April 22, 1966. (Doc. No. 24.) This case is brought to this Court by petition for review filed on June 21, 1966 (Doc. No. 25), within the three-month period prescribed in Section 7483 of the Internal Revenue Code of 1954. Jurisdiction is conferred on this Court by Section 7482 of that Code.

QUESTION PRESENTED

Did the Tax Court correctly disallow certain deductions claimed by the taxpayer on the ground that they were not substantiated by the evidence of record?

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code of 1954:

> SEC. 162. TRADE OR BUSINESS EXPENSES.
>
> (a) In General.--There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including--
>
> * * *
>
> (26 U.S.C. 1964 ed., Sec. 162.)
>
> SEC. 165. LOSSES.
>
> * * *
>
> (c) Limitation on Losses of Individuals.--In the case of an individual, the deduction under subsection (a) shall be limited to--

(1) losses incurred in a trade or business;

(2) losses incurred in any transaction entered into for profit, though not connected with a trade or business; and

* * *

(26 U.S.C. 1964 ed., Sec. 165.)

SEC. 212. EXPENSES FOR PRODUCTION OF INCOME.

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year--

(1) for the production or collection of income;

* * *

(26 U.S.C. 1964 ed., Sec. 212.)

Treasury Regulations on Income Tax (1954 Code):

§ 1.162-5 [As amended by T.D. 6918, 1967-21 Int. Rev. Bull. 8] Expenses for education.

(a) General rule. Expenditures made by an individual for education (including research undertaken as part of his educational program) * * * are deductible as ordinary and necessary business expenses (even though the education may lead to a degree) if the education--

(1) Maintains or improves skills required by the individual in his employment or other trade or business, or

(2) Meets the express requirements of the individual's employer, or the requirements of applicable law or regulations, imposed as a condition to the retention by the individual of an established employment relationship, status, or rate of compensation.

* * *

(26 C.F.R., Sec. 1.162-5.)

STATEMENT

The facts as found by the Tax Court may be stated as follows:

P. R. McClung (hereafter referred to as taxpayer) filed a join federal income tax return with his wife for the taxable year 1960 with the District Director of Internal Revenue at Los Angeles, California. (Doc. No. 23, p. 1.)

On his return the taxpayer claimed deductions of $874.01 for losses and expenses incurred in business transactions entered into a hope for profit, and $199.86 for educational expenses incurred by his wife (Doc. No. 23, p. 2). The Commissioner disallowed the clai deductions and determined an income tax deficiency of $160.06 (Doc. 23, pp. 1, 2).

During the year in question the taxpayer was employed by the Southern California Presbyterian Homes as a maintenance man; his dut consisted of fixing doors, unstopping plumbing, and handling maintenance jobs of that nature. (Doc. No. 23, p. 2). He contended tha since 1932, he had also engaged in various business ventures with a view to profit and that the deductions he took in his 1960-tax year were related to his ventures for that year. (Doc. No. 23, p. 2 The nature of these business ventures was not revealed to the Tax Court which found his answers "indefinite and unresponsive". (Doc. No. 23, p. 2.) From the type of expenses claimed (e.g. patent drawing photostats, and Geological Survey Maps) one might speculate that these ventures related to mining and patents, but nothing more definite can be stated. The taxpayer's income tax returns for the years 1959, 1960, and 1961 reflect only income from wages and salaries. (Doc. No. 23, p. 2.) He admitted that he had not made any profit from his alleged ventures since

1932, except perhaps in one year which he could not identify; and that even the amount of the alleged profit for such year was minimal. (Doc. No. 23, p. 2.) The Tax Court found (Doc. No. 23, pp. 2-3) that the taxpayer did not maintain any business books or records and also that he failed to produce any evidence in the Tax Court to substantiate any of his alleged business losses or expenses or their deductibility.

Taxpayer also deducted on his return for the year here involved, an item of $199.86 which he therein described as "Schooling to Maintain and Improve Skills." The Commissioner disallowed this deduction. (Doc. No. 23, p. 2.) In the Tax Court the taxpayer testified that this item represented educational expenses incurred by his wife who was a nurse. Although the taxpayer's wife was not called upon to testify, it appears that she was a nurse's aide at a rest home, and that she terminated her employment to attend college with the intention of becoming a licensed vocational nurse. (Doc. No. 18, p. 56, 57.) The Tax Court found that the taxpayer failed to substantiate any particular expense so incurred; and failed to present any evidence which would tend to establish that any such expense was incident to maintaining or improving any of his wife's skills. (Doc. No. 23, p. 2.) The Tax Court in sustaining the deficiency as determined by the Commissioner held that both of the claimed deductions should be denied on the ground that the taxpayer had failed to carry his burden of proof with respect to their deductibility. (Doc. No. 23, p. 3.)

From that action the taxpayer has filed and prosecuted the instant petition for review. (Doc. No. 25.)

SUMMARY OF ARGUMENT

The taxpayer seeks deductions claimed to represent losses and expenses incurred in business transactions entered into with a hope for profit and educational expenses allegedly incurred by his wife in maintaining and improving her nursing skills.

The taxpayer has failed to state the Code sections upon which he bases these claimed deductions, however it appears that if the claimed deductions are allowable they would fall within the purview of Sections 162(a), 165(c)(1) and (2), or 212 of the Internal Revenue Code of 1954. It is well established that a taxpayer who claims deductions under these sections has the burden of establishing his right to such deductions. The Commissioner's determination in this regard is presumptively correct and the burden rests upon the taxpayer to overcome such presumption by sufficient proof. The Commissioner determined that the deductions claimed by the taxpayer in the instant case were not allowable. The Tax Court determined that the taxpayer had failed to prove that he was entitled to the claimed deductions and that the Commissioner's determination must stand in the light of the taxpayer's insufficient proof. The record shows that the taxpayer failed to substantiate these claimed deductions after being given every reasonable opportunity to do so by the Tax Court, the decision should be affirmed.

ARGUMENT

THE TAX COURT CORRECTLY DISALLOWED DEDUCTIONS CLAIMED BY THE TAXPAYER ON THE GROUND THAT THE DEDUCTIONS WERE NOT SUBSTANTIATED BY THE EVIDENCE OF RECORD

A. The Tax Court correctly held that the taxpayer had failed to substantiate his claim to deductions for alleged business expenses and losses for the taxable year 1960

Sections 162 and 212 of the Internal Revenue Code of 1954, supra, permit a deduction from gross income for ordinary and necessary expenses paid or incurred in carrying on a trade or business, or expenses incurred for the production of income. Subsections (c)(1) and (2) of Section 165 of the Internal Revenue Code of 1954, supra, also permit a deduction for losses incurred in a trade or business and losses incurred in any transactions entered into for profit, though not connected with a trade or business. Since these deductions, like other deductions, are a matter of legislative grace, the taxpayer must establish his right to the particular deduction claimed and its proper amount. Burnet v. Houston, 283 U.S. 223; New Colonial Co. v. Helvering, 292 U.S. 435; E. & J. Gallo Winery v. Commissioner, 227 F. 2d 699 (C. A. 9th); South Jersey Sand Co. v. Commissioner, 267 F. 2d 591 (C. A. 3d); Patten Fine Papers v. Commissioner, 249 F. 2d 776 (C. A. 7th). This principle is in keeping with the rule that the determination of a deficiency in tax by the Commissioner is presumptively correct and the taxpayer has the

burden of showing it to be incorrect. Welch v. Helvering, 290 U.S. 111; Jacobs v. Commissioner, 224 F. 2d 412 (C. A. 9th); Strawder v. Commissioner, 277 F. 2d 753 (C. A. 5th).

In the instant case the taxpayer seeks a deduction in the amount of $874.01, claimed to represent losses and expenses incurred in business transactions entered into with a hope for profit. (Doc. No. 23, p. 2.) This amount was disallowed as a deduction by the Commissioner (Doc. No. 23, p. 2), and such disallowance was sustained by the Tax Court for lack of substantiation (Doc. No. 23, p. 3).

The difficulty with the taxpayer's case is that despite a hearing which lasted one hour and twenty minutes, he never identified the trade or business, or profit-seeking enterprise in connection with which the deductions were sought. From the nature of some the expenses claimed, one might surmise that the ventures had something to do with mining and patents, but we know nothing more definite. Furthermore, the bulk of the deductions were for customary personal expenditures like automobile travel, parking, and stationery, so that even if the taxpayer were involved in some sort of profit-seeking venture, it is impossible to say that the expenses were related to it.

The Court questioned the taxpayer about his ventures and his alleged expenses and found his answers indefinite and unresponsive. The difficutly which faced the court can be demonstrated by the following typical colloquy (Doc. No. 18, p. 31-33):

Q Not at this time. Would you explain to the Court and myself, if you would, exactly what you claim your business is? I fail to understand at this time.

A Now, listen, these are transactions.

MR. WHITE: Your honor, we would request that petitioner answer the question and explain to the Court and respondent what his business is so we will at least know where to proceed.

THE WITNESS: May I read something that was taken from Black's law dictionary?

THE COURT: We won't argue that now. He wants you to tell now, in your own words, not what Black said. I know your theory, at least what you have been saying, that you have to have a profit motive. That is your argument.

THE WITNESS: May we have the reporter read what I said about Sears Lake in those patent transactions?

THE COURT: It would be some job go find it. Suppose you restate it now. What is your business? You say two thirds of this mail box is for business, $62 in postage is all for business. What business?

THE WITNESS: I entered these transactions, certain deals, for the purpose of making a profit. They had good prospects, and I put money in it, and I realized it was wasted.

Now, I don't think I am alone in putting money out on things that look good.

THE COURT: Is it not clear to me what kind of thing you though was a good business, and how much money you put in.

You say you put money in. What money did you put in? What was the business? You have talked about fixing doors and plumbing.

THE WITNESS: Your honor, that was my occupation for a livelihood; these are outside. The question before us involves these deals I entered.

THE COURT: What deals?

THE WITNESS: Those up on Sears Lake, and those patents, and it involved so much patent research.

MR. WHITE: Your honor, respondent at this time is going to state that he could not, from what Mr. McClung has testified, ascertain what business he would be in, and the burden of proof being on the petitioner we feel we are just trying to help him in substantiating some of his case.

However, with no cooperation, we have no choice but to move the Court to find for the respondent in this instance, because he was clearly not following the purview of any section of the Internal Revenue Code, your honor.

THE WITNESS: When my turn comes to argue I will present the laws here on such deals, even though they are not a taxpayer business, they were transactions the expenditures in which are deductible.

I have a list of laws here on that, when my turn comes to make the presentation.

THE COURT: Well, you can put those in a brief. I am not going to read law here on the bench now. I am here to gather the evidence and gather the facts.

Now, I want to know what kind of business it is. He has asked you for your business. You have mentioned activities that you engaged in.

THE WITNESS: That is the word; that is a good word.

On the basis of this and similar testimony the Tax Court correctly concluded (Doc. No. 23, p. 2-3):

> He did not maintain any business books or records of any sort; and there is no evidence which would substantiate any of his alleged business losses or expenses, or the deductibility thereof. In this situation we here find and hold that petitioner has failed to carry his burden of establishing any error in respondent's disallowance of the claimed business losses and expenses above mentioned.

Since the burden was upon the taxpayer to rebut the presumptive correctness of the Commissioner's determination, the Tax Court was more than justified upon this record in determining that the taxpayer had failed to carry that burden. This issue presented a pure question of fact and there was a failure of proof on the taxpayer's part. Accordingly, the Tax Court's decision being in harmony with the record facts should be affirmed. Commissioner v. Duberstein, 363 U.S. 278.

B. The Tax Court properly disallowed the claimed educational expense deduction for the taxable year 1960 on the ground that the claimed deduction was not substantiated

As we have pointed out, supra, Section 162(a) permits a deduction for ordinary and necessary expenses incurred in carrying on a trade or business. Treasury Regulations on Income Tax, Section 1.162-1(a), supra, allows a deduction for expenditures made by a taxpayer for education, if the education maintains or improves the skills required by the taxpayer in his employment, or other trade or business, or meets the express requirements of the taxpayer's employer, or the requirements of the applicable law or regulations, imposed as a condition to the retention by the individual of an established employment relationship status, or rate of compensation. Taxpayer in his

return for 1960 deducted an item of $199.86, which he therein described as for "Schooling to Maintain and Improve Skills." (Doc. No. 23, p. 3.) The Commissioner disallowed the claimed deduction in its entirety. (Doc. No. 23, p. 23.) In the Tax Court the taxpayer testified that the claimed deduction represented educational expenses incurred by his wife who was a nurse.

The taxpayer testified that his wife was working as a practical nurse, that she attended Mount San Antonio College, that she received the same salary when she resumed work at the end of the course as she had before, and that she took the course to increase her proficiency and to maintain her ability. (Doc. No. 18, p. 54.) Since that testimony was undeniably vague and indefinite, counsel for the Commissioner indicated to the Court his understanding of the facts on the basis of independent investigation of the issue. Those facts showed, according to counsel (Doc. No. 18, p. 58):

> * * * that Mrs. McClung was working, she quit work, she attended school, which we believe was with the intent of becoming a licensed vocational nurse, which is no longer maintaining and improving present skills and capacities, and then, because of the illness of one of her children, had to terminate her employment where she went with another

> independent hospital not related to the first.
>
> Therefore, as a matter of law, she would not be entitled to any deduction.

In addition to the legal question, counsel pointed out that the taxpayer had failed to demonstrate that the expenses he claim were actually incurred, were related to his wife's education, or h not already been deducted from their income (see Doc. No. 18, pp. 57, 58). Thus, the Tax Court was forced to conclude that the taxpayer had (Doc. No. 23, p. 3):

> * * * failed to substantiate any particular expense so incurred; and he presented no evidence which would tend to establish that any such expense was incident to maintaining or improving any of his wife's skills. We hold therefore that the petitioner has failed to carry his burden of proof as to the deductibility of the alleged expense here considered.

As previously noted, the burden is upon the taxpayer to establish his right to any claimed deduction. It is clear from the record in the instant case that the taxpayer has failed to carry that burden. This being the case the Tax Court in accordance with the record properly sustained the Commissioner's disallowance of the claimed deduction.

CONCLUSION

For the reasons stated above, the Tax Court is correct with respect to the issues dealt with by it and accordingly such decision should be affirmed.

Respectfully submitted,

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September, 1967.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: _____ day of _____, 1967

_____
Chester C. Davenport